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The Manufacturers Hanover
Financial Digest
Economic Commentary, Selected Financial Data, and Business Indicators

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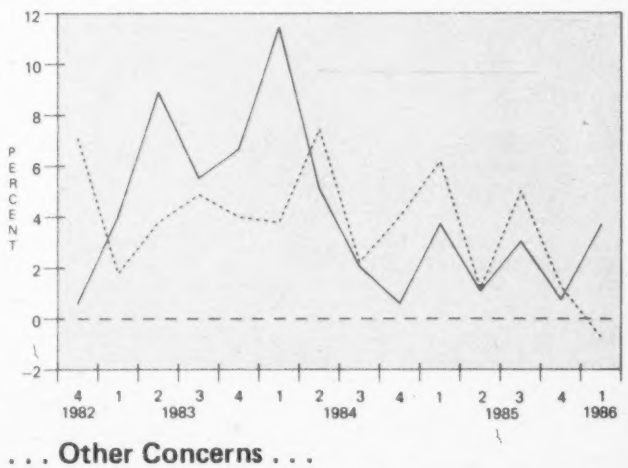
Despite Economic Sluggishness . . .

In recent weeks, the financial markets have been buffeted by the crosscurrents of a less than robust pace of business here and abroad, a pronounced acceleration of money supply growth, a decided firming of oil prices and heightened concerns over the downside vulnerability of the dollar in the foreign exchange markets. In light of this array of factors—some suggesting the need for more monetary ease, others suggesting the opposite—the Federal Reserve's policy-setting Federal Open Market Committee probably decided at this week's meeting to walk a fine line between the two, recognizing that while business conditions preclude a firming of the monetary reins, dollar concerns preclude an easing. This suggests that any monetary policy change will be put on hold for now, while the central bank awaits more definitive signs of the economy's response to the easing actions already taken.

To be sure, an ample array of mixed economic signals adds to the usual uncertainty surrounding both the future growth pace and the appropriate posture of monetary policy. Take, for example, the real GNP growth rate. Despite widespread predictions to the contrary, the Commerce Department revised upward its estimate of the first quarter, inflation-adjusted growth rate, from a preliminary 3.2 percent annual rate to a seemingly healthier 3.7 percent annual clip—the strongest advance in a year. At first glance, the economy would appear to be perking up from last year's lethargy, needing little further monetary stimulation. But, as is often the case, first appearances can be deceiving. For when the GNP-boosting effect of a hefty buildup of business inventories is netted out, a somewhat different picture emerges: The first quarter-over-quarter drop in inflation-adjusted final sales (GNP minus the change in inventories) since the onset of the current business expansion 3½ years ago (see chart).

Indeed, although a pickup in business activity had been expected by now due to tumbling oil prices and interest rates, few signs of this are readily apparent. While the unemployment rate moved a tenth of a percentage point lower in April, payroll employment rose only modestly; all of the jobs gains were concentrated in the services-construction side of the economy, while manufacturing employment continued to drop. So, too, the recent upturn in auto sales and the surge in housing starts have been offset, to some extent, by the generally lackluster pace of nonauto retail sales and the ongoing malaise in the manufacturing sector. While the ingredients of a business upturn are certainly in place—interest rates at their lowest levels in nearly a decade and the dollar's external value now well below the highs reached a year ago—signs of either a consumer-led, or export-led acceleration of growth have yet to materialize.

REAL GNP (LINE) VS. REAL FINAL SALES (DOT)
(QUARTER-OVER-QUARTER PERCENT CHANGE AT ANNUAL RATE)



. . . Other Concerns . . .

Nor is the United States the only country awaiting an as yet unrealized business upturn. In Germany, a barrage of weak, March economic statistics—ranging from a drop in domestic and foreign factory orders to another monthly decline in industrial production—point to a pace of business considerably weaker than originally anticipated. Real GNP growth apparently stalled in the first quarter—and may have actually eased—while the unemployment rate remains in the nine percent zone. What is more, the dimming of German growth prospects clouds the outlook for much of the rest of Western Europe—already prompting France to scale back its 1986 growth expectations. Add to this the fact that industrial production in March eased in both Japan and the United Kingdom, and a picture emerges of soft business conditions throughout a large part of the industrial world.

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While it could reasonably be expected that industrial country central banks will respond to such business conditions with more monetary policy ease, the timing of such a move, especially in the United States, is more uncertain than usual. For it will depend not only on the second quarter's economic numbers, but also the degree of the Fed's concern over two other things: First, the sharp acceleration in money supply growth now underway and second, the downside vulnerability of the dollar in the foreign exchange markets. In each instance, there are risks associated with another turn toward more monetary ease.

The growth of the M1 money supply, for example, has accelerated sharply in recent weeks, advancing at a nearly 20 percent annual clip over the past four, while the growth of the broader M2 money supply has picked up as well. It rose by nearly $30 billion in April alone, placing its year-to-date growth back within its 1986 target range. Although the Fed continues to tolerate this trend—pumping liquidity into the banking system at a torrid clip—and will probably continue to do so until such time as the growth of M2 approaches its upper target boundary, there has to be some limit to this generosity, especially if inflation expectations are to remain in check.

. . . Could Preclude More Monetary Ease

So, too, if a downward slide of the dollar in the foreign exchange markets accompanies more ease

Selected Federal Reserve Data

(Averages of Daily Figures—Billions of Dollars)

	Week Ending	$ Change Since Week Ago	$ Change Since Year Ago
Reserve Bank Credit	5/21/86		
U.S. Gov'ts and Agencies Owned Outright & RPs	188.359	+ 1.530	+ 15.641
Loans to Depository Inst.	.848	+ .042	− .626
Float	.396	− .392	− .195
Total Reserve Bank Credit	204.580	− .520	+ 18.530
Treasury Deposits with Federal Reserve Banks	3.972	− .619	+ .834
Currency in Circulation	196.453	+ .067	+ 13.416
Gov'ts held for Foreign Acct. by FR. Banks (End-of-Week)	148.311	+ 2.713	+ 29.124
Member Bank Reserves:	5/21/86		
Total Reserves\Held	47.579	− .183	+ 6.857
Excess (Deficiency)	.739	− .139	− .113
Net Free Reserves	.483	− .051	+ .696
Monetary Aggregates†		% Change Since Three Months Ago*	% Change Since Year Ago
M1 (5/12/86)	656.0	+ 14.9‡	+ 12.6‡
M2 (April '86)	2,620.8	+ 8.0	+ 7.7
M3 (April '86)	3,287.7	+ 7.9	+ 7.7
Domestic Nonfinancial Debt (4th Q'85)	6,867.9	+ 19.2	+ 14.7

† Seasonally adjusted.

* Seasonally adjusted annual rate.
‡ Four-week moving average.

New York Money Market

	3 Months	6 Months	1 Year
Offering Rates 5/23/86			
‡ U.S. Treasury Bills	6.17%	6.23%	6.28%
* Federal Agencies	6.44	6.42	6.48
* Municipal Notes—High Grade (46% Taxable Equivalent)	7.41	7.04	7.69
Negotiable Time CDs Manufacturers Hanover		Rates By Arrangement	
* Secondary Market—Prime	6.70	6.70	6.80

‡ Finance Company Paper—Prime		‡* Bankers' Acceptances	
5- 14 days	6.73%	Jun.	6.78%
15- 29 days	6.75	Jul.	6.70
30- 59 days	6.75	Aug.	6.68
60- 89 days	6.75	Sep.	6.65
90-179 days	6.60	Oct.	6.62
180-239 days	6.30	Nov.	6.60
240-270 days	6.30		

‡ Industrial Paper—Prime			
30- 89 days	6.73%	† Federal Funds Effective Rate	6.85%
90-120 days	6.65		

‡ Discount basis. * Subject to availability. † Estimated.

Selected Business Indicators

(All Dollar Figures in Billions)

	Latest Period or End of Period		Previous Period	Year Ago Period
Gross National Product (Current Dollars)*	1st Q'86	$ 4,121r	$ 4,059	$ 3,918
Gross National Product (1982 Dollars)*	1st Q'86	$ 3,624r	$ 3,591	$ 3,548
Percent Change, Annual Rate	1st Q'86	3.7r	0.7	3.7
Change in Consumer Prices (all urban consumers)*	Apr '86n	− 3.6%	− 4.8%	3.6%
Change in Producer Prices*	Apr '86n	− 7.2%	−13.2%	6.0%
Civilian Employment (Thousands of Persons)†	Apr '86	108,892	108,788	106,872
Unemployment as % of Civilian Labor Force†	Apr '86	7.1%	7.2%	7.3%
Personal Income*	Apr '86n	$ 3,447	$ 3,407	$ 3,289
Leading Indicators Composite Index (1967 = 100)†	Mar '86	176.6	175.7	167.6
Industrial Production Index (1977 = 100)†	Apr '86n	125.1	124.9r	124.1
Net Change in Consumer Installment Credit †	Mar '86n	$ 3.71	$ 5.02r	$ 8.30r
U.S. Merchandise Trade Balance †	Mar '86	−$ 14.52	−$ 11.37	−$ 10.14
Plant and Equipment Expenditures*	2nd Q'86	$400.68(a)	$390.66(a)	$387.83
Private Housing Starts (Thousands of Units)*	Apr '86n	2,009	1,930r	1,851
New Construction Expenditures*	Mar '86	$ 354.6	$ 358.9	$ 333.7
Total Business Inventories †	Mar '86n	$ 587.7	$ 585.2	$ 578.4
Total Business Sales †	Mar '86n	$ 420.3	$ 427.2	$ 420.3

*Seasonally adjusted annual rate. †Seasonally adjusted. n-Newly reported figure. r-Revised. a-Anticipated.

and lower interest rates, this, too, would complicate the Fed's inflation-fighting objectives—producing such commonly cited negatives as import price increases and, perhaps, diminishing the appetite of Japanese financial institutions for dollar-denominated assets. But, in this environment, it could also lead to something else, namely, the possible unraveling of the entire Group of Seven (G-7) framework. Japanese and German policy-makers are becoming increasingly vocal in their concern over the negative consequences of the ongoing appreciation of their currencies relative to the dollar. After relying for years on export-led growth, this prop is fast disappearing with little emerging to replace it. Any unilateral switch to more ease here, without similar foreign steps, could hasten the dollar's descent, and further cloud business prospects in Japan and Germany.

Thus, while global business conditions may well warrant more monetary ease, these steps must be undertaken in a way that produces a balanced, global business upswing—not one which has one country benefiting at the expense of another. For the Fed, already wary of the acceleration in money growth, this means holding policy steady for another month or two, marking time as it awaits the response of the economy here, and those abroad, to actions already taken. If, at that time, the pace of global business remains soft, more ease and lower short-term interest rates are a good bet—not in isolation, but in tandem with the other industrial countries. H

Short Term Paper Outstanding

(Millions of Dollars)

	Latest Week	Change Since Week Ago	Change Since Year Ago
Time Deposits of $100,000 or more Weekly Reporting Banks	-		
Nationwide (5/7/86)	155,948	– 126	– 220
New York City (5/14/86)	34,487	– 197	+ 645
Commercial Paper (5/14/86)	307,816	+ 3,894	+49,563

Bank Loans

(Millions of Dollars)

Commerical and Industrial Loans

Weekly Reporting Large Commercial Banks	Latest Week	Change Since Week Ago	Change Since Year Ago
Nationwide (5/7/86)	261,509	+ 545	+ 4,253
New York City (5/14/86)	58,087	+ 110	– 4,465

Total Loans and Leases Gross Adjusted

	Latest Week	Change Since Week Ago	Change Since Year Ago
Nationwide (5/7/86)	733,804	– 5,148	+59,246
New York City (5/14/86)	157,561	– 876	+ 9,841

Financial Markets

	Friday 5/23/86	Change Since Week Ago	Change Since Year Ago
U.S. Governments, Closing Yields:			
90-Day Bills†	6.33%	– .04	– 1.06
180-Day Bills†	6.50	– .05	– 1.25
Longest Bills†	6.67	– .10	– 1.48
Recent Issues:			
7⅛s 5/31/88 (When Issued)	7.14	NA	
7¼s 3/31/90	7.57	– .16	
7⅜s 5/15/96	7.86	– .11	
7¼s 5/15/16	7.46	– .19	
Municipals:			
Bond Buyer—20 Bond Index* (5/22/86)	7.78%	+ .25	– 1.13
Blue List Total ($ Million)	$2,130	– $ 105	+ $ 238
30-Day Visible Supply ($ Million)	$3,679	– $1,547	+ $ 494
Total	$5,809	– $1,652	+ $ 732
Corporates:			
Moody's Aa Composite (5/22/86)	9.52%	+ .08	– 2.60
30 Day Supply ($ Million)	$3,292	+ $192	+ $2,784
Stocks:			
Dow-Jones Averages:			
Industrials	1,823.29	+ 63.49	+ 521.32
Transportation	797.96	+ 26.26	+ 170.41
Utilities	184.35	+ 3.30	+ 22.37
65 Stocks	706.71	+ 22.53	+ 173.16
N.Y.S.E. Composite Index	138.88	+ 4.44	+ 30.01
N.Y.S.E. Avg. Daily Vol. for Week (000's)	118,280	– 6,074	+ 5,336

* 48% Taxable equivalent 14.41%

† Bond equivalent.

International Rates

EURODOLLAR DEPOSIT RATES (bid)	Friday 5/23/86	Week Ago
Overnight	6.62%	6.75%
1 month	6.94	6.94
3 month	6.94	6.94
6 month	6.94	7.00
1 year	7.13	7.13
EURODOLLAR BONDS Average Yield		
Medium Term (5 to 7 yrs.)	8.15%	7.90%
Long Term (7 to 15 yrs.)	8.50	8.30

FOREIGN EXCHANGE SPOT RATES

New York Opening (5/23/86)	U.S. $ Equivalent	Currency Per U.S. $
Belgium	.02150	46.52
Canada	.7334	1.3635
Denmark	.1192	8.3900
France	.1377	7.2600
Germany	.4389	2.2785
Italy	.0006400	1562.50
Japan	.005894	169.65
Mexico	.001843	542.50
Netherlands	.3902	2.5630
Switzerland	.5289	1.8908
U.K.	1.4915	.6705

Better than ever in our 20th year.

The Manufacturers Hanover Westchester Classic will be held at the Westchester Country Club in Harrison, NY, June 2-8, 1986.

- Roger Maltbie, defending champion and other top pros from the PGA Tour, will compete for $600,000 in prize money, and the winner's purse of $108,000.
- Proceeds help support the following area hospitals: United, Lawrence Auxiliary, New Rochelle, Northern Westchester, Phelps Memorial, St. Agnes, St. John's, St. Joseph's, St. Vincent's, Blythedale Children's, Greenwich, Mount Vernon, White Plains, Yonkers General.
- Tickets on sale at all these hospitals through June 1st, thereafter at the gate. To charge with MasterCard or VISA, call 212-808-8519, Monday to Friday, 9am-5pm.
- For more information call (914) 967-5356.

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